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No. 91-321

Supreme Court, U.S.
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In The

# Supreme Court of the United States

October Term, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,

*Petitioner,*

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE,

*Respondent.*

## Petition For A Writ Of Certiorari To The Supreme Court Of Tennessee

## BRIEF IN OPPOSITION TO THE PETITION

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## QUESTIONS PRESENTED

1. Whether a state sales tax levied on the privilege of engaging in business in the taxing state, which is measured by the gross proceeds derived by a lessor from lease contracts in which the leased property is located in and delivered to the lessee in the taxing state, is precluded by the Foreign Commerce Clause from being imposed on such leases of cargo containers which are ultimately used in international commerce.

2. Whether such a state tax is preempted by the Customs Conventions on Containers.

3. Whether such a state tax is precluded by the Import-Export Clause.

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JOE HUDDLESTON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE,

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**Petition For A Writ Of Certiorari To The Supreme Court Of Tennessee**

## BRIEF IN OPPOSITION TO THE PETITION

### STATEMENT OF THE CASE

The Tennessee Department of Revenue assessed sales tax against Itel Containers International Corporation as a result of Itel's substantial business activities transacted wholly within Tennessee. Itel is a Delaware corporation, based in California, which operates business facilities and locates substantial amounts of its property in Tennessee. Itel is primarily engaged in the business of furnishing, as lessor, cargo containers to its customers for their use in transporting goods in international commerce.

The Department assessed tax for business activities which occurred in Tennessee during the audit period of January 1, 1983, through November 30, 1986. Tax was assessed upon the gross proceeds derived by Itel from its lease contracts in which containers stored in Tennessee were delivered in Tennessee to Itel's lessees or their agents.

During the audit period, containers belonging to Itel were placed at depots at such Tennessee locations as Memphis, Nashville, and Chattanooga. Also, during the latter part of the audit period, Itel maintained a terminal of its own at Memphis. The terminal, staffed by a number of Itel employees, was used by Itel to receive incoming containers being returned at the conclusion of their leases, to store containers, and to perform repair work, and as the site at which containers going out on lease were delivered to and picked up by Itel's customers.

Itel's containers, while under lease, were used exclusively in international commerce. However, Itel was not itself an importer, exporter, or shipper of the goods transported in such containers. Each container was brought into Tennessee at the conclusion of one lease and stored there until it was delivered to another customer at the beginning of another lease. Thus, the container's presence in Tennessee was not a part of a continuous lease term or of a continuous journey carrying goods.

Originally, the sales tax assessment in this case also included Itel's proceeds from leases in which containers stored in Tennessee were delivered at out-of-state locations. The trial court disallowed that portion of the



assessment, holding that where delivery was consummated outside Tennessee the transactions were not properly taxable by Tennessee. (App. at 20a-21a). The Department of Revenue did not appeal that holding, but accepted it as a proper decision under the facts and law.

Both the trial court and the Tennessee Supreme Court upheld the portion of the assessment attributable to Itel's leases in which delivery to the lessees occurred within Tennessee. Itel now seeks further review of that Tennessee Supreme Court decision.

## REASONS FOR DENYING THE WRIT

The decision of the Tennessee Supreme Court does not conflict with the decisions of this Court, federal courts of appeals, or other state courts of last resort. This case was correctly decided, based upon Tennessee law interpreting the nature and scope of the sales tax statutes, and upon analytical guidelines announced by this Court in prior cases. Because the tax in this case was upon the proceeds of business activities conducted by an American corporation entirely within the taxing state, this case has very little significance to the development of foreign policy issues or Import-Export or Commerce Clause jurisprudence. For all of these reasons, further review is unwarranted.

## I. THE TENNESSEE COURT PROPERLY ANALYZED THE NATURE OF THE TAX AND THE TRANSACTIONS IN THIS CASE, CONSISTENT WITH THIS COURT'S DECISIONS.

Itel misapprehends, and thus mischaracterizes, the nature of the tax in this case. The sales tax here was imposed on Itel's business activities; it was not a property tax on the containers, such as the tax stricken in *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). Tenn. Code Ann. § 67-6-201 provides:

> It is declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state . . . or who rents or furnishes any of the things or services taxable under this chapter . . . or who leases or rents such property, either as lessor or lessee, within the State of Tennessee. . . .

The sales tax is not an *ad valorem* property tax, but instead a privilege tax on persons engaging in certain types of business activities in Tennessee. *Hooten v. Carson*, 186 Tenn. 282, 285, 209 S.W.2d 273 (1948). Property taxes are direct taxes on the value of the property, and therefore require some appraisal and assessment of the actual value. The Tennessee sales tax, on the other hand, is measured not by the value of the property, but by the total consideration, or the "gross proceeds," received under a contract of sale or lease. Itel erroneously asserts that the rentals received under a lease are simply that portion of the value of the leased property corresponding to the time limits of the lease. Realistically, however, the consideration in a lease contract is simply a figure agreed upon by the parties to reflect numerous factors. Often the consideration in a lease contract bears scant relationship to the actual value of the leased property.



Tennessee's sales tax on leasing activity is measured by the "gross proceeds" of the lease, which includes everything of value received by the lessor under the lease, and is not determined necessarily by the value of the leased property. *Furniture Lease Co. v. Tidwell*, 495 S.W.2d 535, 536 (Tenn. 1973). The taxable gross proceeds of a lease include charges, often hidden or "built-in," for services rendered by the lessor. *Saverio v. Carson*, 186 Tenn. 166, 168, 208 S.W.2d 1018 (1948). Therefore, Tennessee's sales tax on leases is not a direct tax on property, and is not measured by the value of property. Instead, Tennessee's tax measured by the gross proceeds of leases is more akin to a tax on income derived from leases. Such a tax is patently distinguishable from the flat, direct property tax in *Japan Line*.[1]

Itel also incorrectly characterizes the Tennessee tax as a "transit fee on the privilege of moving through a State."

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[1] In *Japan Line*, this Court took note of the Convention Between the United States of America and Japan for the Avoidance of Double Taxation, Mar. 8, 1971 [1972], 23 U.S.T. 967, 1084-1085, T.I.A.S. No. 7365, which provided that income "derived by a resident of a Contracting State . . . from the use, maintenance, and lease of containers and related equipment . . . in connection with the operation in international traffic of ships or aircraft . . . is exempt from tax in the other Contracting State." *Japan Line*, 441 U.S. at 446, n.10. Thus, as that international agreement, and this Court, recognized, a tax on proceeds derived from the lease of containers is plainly different from a direct property tax on the containers themselves.

However, the tax here is a generally applicable tax on all business activity in Tennessee involving the transfer of possession of tangible personal property for consideration, and is not aimed selectively at items merely passing through the state. To the contrary, Tenn. Code Ann. § 67-6-313(a) expressly provides:

> It is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export.

This "import-for-export" exemption clearly provides that if, for example, Itel imported its containers into Tennessee and then itself exported the containers, without transferring them to lessees while in Tennessee, the sales tax would not be imposed. *Beecham Laboratories v. Woods*, 569 S.W.2d 456, 458 (Tenn. 1978). It is only when some intervening transfer of title or possession occurs in Tennessee – in other words, when specific business activity occurs in Tennessee – that the tax is imposed. *Jack Daniel Distillery v. Jackson*, 740 S.W.2d 413, 416 (Tenn. 1987). Thus, the sales tax in this case does not necessarily reach all of Itel's containers moving through Tennessee. Tax is imposed only when Itel engages in specific and substantial business activity – transfer of possession to a lessee for consideration – in Tennessee. The trial court recognized this when it disallowed tax on transactions in which Itel delivered containers from its various Tennessee locations, but where the transfer of possession to the lessee for consideration occurred outside Tennessee. (Chancery Court Memo., App. at 20a-21a). It should be noted that this portion of the trial court's ruling, favorable to Itel, was not appealed by the Commissioner of Revenue.



Similarly, Itel is incorrect in characterizing the Tennessee sales tax as a tax "chargeable by reason of importation," or "collected on, or in connexion with, the importation of goods," as those terms are used in the Customs Conventions on Containers. *See* 1956 Customs Convention on Containers, May 18, 1956 [1969], 20 U.S.T. 301, Art. 1(a) (App. at 41a); 1972 Customs Convention on Containers, Dec. 2, 1972 [1985], 988 U.N.T.S. 43, Art. 1(a) (App. at 39a). The Tennessee tax simply is not levied on imports, but is a generally applicable sales tax. Further, many imports, including many of Itel's imported containers, are never involved in taxable transactions in light of the "import-for export" exemption expressly provided by Tenn. Code Ann. § 67-6-313(a). The Customs Conventions on Containers, so broadly relied upon by Itel, do not even address, much less forbid, Tennessee's sales tax.

The fact that Itel's transfers of containers in Tennessee are taxable, while containers from Tennessee which are transferred out-of-state are not taxable, further illustrates that the tax here is not upon the containers themselves, but rather upon the business activity engaged in by Itel in Tennessee. Further still, the incidence of the sales tax in this case was not upon the containers, or the lessees of the containers, but upon Itel as lessor. *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). Although Tennessee statutes provide for Itel to pass the tax on to its customers, if possible, the legal burden of and ultimate liability for the tax are only upon Itel. *Id.; Smoky Mountain Canteen Co. v. Kizer*, 193 Tenn. 598, 603, 247 S.W.2d 69 (1952). The tax is not upon the value of certain property, but upon the business activities in Tennessee of a company which chooses to locate its business in Tennessee

and enjoy the benefits and protections furnished by the State.

Therefore, the Tennessee Supreme Court correctly held that the tax in this case is not a direct tax on the containers, such as the property tax in *Japan Line* (App. at 12a), but is a tax on Itel's business activities, discrete transactions occurring only within Tennessee. (App. at 14a).

## II. THE TENNESSEE SUPREME COURT'S DECISION IN THIS CASE DOES NOT CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT OR OF OTHER COURTS.

Because the Tennessee Supreme Court correctly understood the true nature of the Tennessee sales tax, it correctly held that the tax withstood Itel's constitutional challenges.

The Tennessee court correctly found that the tax in this case is different from the direct *ad valorem* property tax in *Japan Line*, and that the *Japan Line* opinion does not even purport to reach the facts of this case. (App. at 7a-8a). *Japan Line*, 441 U.S. at 444, n.7. Instead, the sales tax on Itel's business activities in Tennessee is more analogous to the taxes upheld against similar constitutional challenges in *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 471 U.S. 1 (1986) (sales tax on fuel used in international aviation), and *Dept. of Revenue v. Ass'n of Washington Stevedoring Companies*, 435 U.S. 734 (1978) (business and occupation tax on stevedoring activities). (App. at 12a). Nonetheless, the Tennessee court followed the guidelines set forth in the *Japan Line* decision for



analysis of the foreign commerce element of the Commerce Clause, U.S. Const. Art. I, §8, cl. 3. (App. 12a). Therefore, the decision in this case does not conflict with the *Japan Line* decision, but instead follows the analytical path laid out by *Japan Line*, *Wardair*, and *Washington Stevedoring*.

Similarly, the Tennessee court's rejection of Itel's challenges under the Import-Export Clause, U.S. Const. Art. I, §10, cl. 3, does not conflict with the recent decision in *Louisiana Land and Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir. 1990), *cert. denied*, ___ U.S. ___ , 111 S.Ct. 248 (1991), relied upon by Itel. In *Louisiana Land*, the challenged Alabama tax was levied specifically on fuel, and was not a generally applicable sales tax such as the Tennessee tax in this case. 900 F.2d at 817, n.1. Because the Alabama tax was aimed at a specific category of goods, it was susceptible to being used to create a special tariff, in violation of the Import-Export Clause. *See Washington Stevedoring*, 435 U.S. at 753. Further, the incidence of the Alabama tax was on the consumer, unlike the Tennessee tax which is levied upon the seller. 900 F.2d at 818. Therefore, the Alabama tax was not a tax on the seller's business activities, but arguably constituted a direct tax on property purchased by the consumer. For those reasons, the tax in *Louisiana Land* is distinguishable from the tax in this case. Regardless of whether goods are "in transit," the Import-Export Clause analysis of direct taxes employed in *Louisiana Land* does not apply when, such as in the present case, the challenged tax is not a direct tax. *Washington Stevedoring*, 435 U.S. at 757. Instead, the Tennessee Supreme Court correctly applied the modern three-prong policy analysis of *Michelin Tire*

*Corp. v. Wages*, 423 U.S. 276, 285-6 (1976), in upholding the tax against Itel's Import-Export Clause challenge. (App. at 17a).

In summary, the decision in this case does not conflict with any decision of this Court, of a court of last resort of any other state, or of any federal court of appeals. The Tennessee Supreme Court correctly decided this case, and further review is unwarranted.

## CONCLUSION

For the reasons set forth above, the Commissioner of Revenue of the State of Tennessee respectfully submits that the decision of the Tennessee Supreme Court in this case is correct, and that further review of this case is unwarranted. Therefore, the petition for writ of certiorari should be denied.

Respectfully submitted,

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